93-695

FILED
NOV 3 1993
OFFICE OF THE CLERK

No. ——

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Petitioner,

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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November 3, 1993

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

25 pp

QUESTION PRESENTED

Whether Congress has authorized federal courts in making property rights determinations concerning federally-regulated bankrupts to preempt the established state trust and property law called for by the Bankruptcy Code in favor of newly-created federal common law designed to further generalized policy interests unrelated to bankruptcy.

LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below (App. 1a) contains the names of the parties.

The Creditors Committee is the exclusive, official body appointed by the United States Trustee pursuant to Section 1102 of the Bankruptcy Code, 11 U.S.C. § 1102, to represent the interests of all of the unsecured creditors of Columbia Gas Transmission Corporation.*

A substantial number of these unsecured creditors are publicly-owned corporations or affiliates or subsidiaries of publicly-owned corporations. According to the Creditors Committee's records, the twenty largest publicly owned creditors are the following:

Ashland Exploration, Inc.
(subsidiary of Ashland Oil, Inc.)

Atlas Resources Inc.

Columbia Gas of Ohio Inc.
(subsidiary of The Columbia Gas System, Inc.)

The Columbia Gas System, Inc.

Columbia Natural Resources Inc.
(subsidiary of The Columbia Gas System, Inc.)

Consolidation Coal Co.
(division of E.I. DuPont de Nemours & Co.)

Energy Development Corporation
(subsidiary of Enterprise Diversified Holdings Incorporated, subsidiary of Public Service Enterprise Group Inc.)

Equitable Resources Energy Company
(subsidiary of Equitable Resources, Inc.)

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* These bankruptcy proceedings are currently pending in the United States Bankruptcy Court for the District of Delaware. *See In re The Columbia Gas System Inc. and Columbia Gas Transmission Corporation,* Case Nos. 91-803 *et al.* (Bankr. D. Del.).

Exxon Company, U.S.A.
(division of Exxon Corp.)

Kentucky West Virginia Gas Co.
(subsidiary of Equitable Resources, Inc.)

Meridian Oil Production, Inc.
(subsidiary of Burlington Resources, Inc.)

Mountaineer Gas Company
(subsidiary of Allegheny & Western Energy Corp.)

Phillips Petroleum Co.

Phillips Production Co.

Samedan Oil Corporation
(subsidiary of Noble Affiliates, Inc.)

Southeastern Gas Co.
(subsidiary of Northern Engineering Corp.,
subsidiary of DWG Corp.)

Texas Eastern Transmission Co.
(subsidiary of Texas Eastern,
subsidiary of Panhandle Eastern Corp.)

Union Pacific Resources Corporation
(subsidiary of Union Pacific Corp.)

Unocal Exploration Corporation
(subsidiary of Unocal Corp.)

Xplor Corporation

According to the Creditors Committee's records, more than 750 unsecured creditors assert claims of $1 million or more, and more than 2000 assert claims of $100,000 or more.

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PETITION FOR A WRIT OF CERTIORARI

The Official Committee of Unsecured Creditors of Columbia Gas Transmission Corporation ("Creditors Committee") hereby petitions for a writ of certiorari to review the decision of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-74a) is reported at 997 F.2d 1039. The opinion of the district court (App. 75a-122a) is not reported. The opinion of the bankruptcy court (App. 123a-144a) is reported at 136 B.R. 930.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 1993. The order of the court of appeals denying the Creditors Committee's petition for rehearing was entered on August 6, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a [bankruptcy] case . . . creates an estate. Such an estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case . . . .
>
> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

STATEMENT OF THE CASE

1. *Bankruptcy Background.* Respondent Columbia Gas Transmission Corporation ("Debtor") is bankrupt and owes billions of dollars to thousands of creditors. Congress in the Bankruptcy Code carefully crafted the priority of payment of claims against the property of bankrupts. See 11 U.S.C. § 101 *et seq.* That statutory framework serves Congress' longstanding policy of "[e]quality of distribution among creditors," *Begier* v. *IRS*, 496 U.S. 53, 58 (1990), while at the same time granting payment priority to certain preferred claims, including claims of the United States. See, *e.g.*, 11 U.S.C. §§ 506, 507. The Code implements those congressional policies by immediately transferring to a bankruptcy estate "all legal or equitable interests of the debtor in property," 11 U.S.C.

§ 541(a)(1), and then automatically staying the efforts of all creditors to collect from the estate the amounts owed them, until a plan of reorganization that recognizes statutory priorities and deals fairly with the claims of all creditors has been confirmed by the bankruptcy court. 11 U.S.C. § 362.

All creditors prefer, of course, to be paid immediately and in full, rather than on a pro-rata basis with their peers. This case involves the Debtor's efforts immediately to pay in full more than $160 million in obligations to respondent customers, many of whom are also its corporate affiliates.[1] Although the Bankruptcy Code forbids such preferential transfers of property of the bankruptcy estate, respondents contend that the Debtor holds the disputed funds in "trust." Property held by a bankrupt in *trust* for another does not become part of the bankruptcy estate, and therefore is not affected by the automatic stay against collection efforts. 11 U.S.C. § 541(d). Indeed, a successful trust claimant is entitled to payment even before secured creditors and priority claimants such as the United States, which here asserts a *$600 million* priority claim against the Debtor.[2]

Because of the obvious advantage attached to trust beneficiary status, "trust" claims are common in bankruptcy and assessing such claims is a recurring and significant aspect of the business of federal courts sitting in bankruptcy. The courts of appeals, however, have split on the critical issue raised here, namely, what body of

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[1] The Debtor is a wholly-owned subsidiary of The Columbia Gas System Inc. ("CG"), which also has filed a petition for bankruptcy. Six of the Debtor's customers, including several of the Debtor's largest customers, are also wholly-owned subsidiaries of CG. These affiliated customers are Columbia Gas of Kentucky, Inc., Columbia Gas of Ohio, Inc., Commonwealth Gas Services, Columbia Gas of Maryland, Inc., Columbia Gas of New York, Inc., and Columbia Gas of Pennsylvania, Inc.

[2] The claim of the United States is asserted by the Internal Revenue Service, a frequent creditor in bankruptcies.

law—established state law or newly-created federal common law—governs such trust claims where, as in this case, the bankrupt is regulated by the federal government pursuant to a nonbankruptcy federal statute.

2. *The Disputed Funds.* The Debtor operates a "downstream" gas pipeline comprised of facilities that reach into gas-consuming states, but not many gas-producing states. The Debtor buys gas and services from "upstream" pipelines located in gas-producing states, and resells them to its customers, state-regulated gas distribution companies.

The "trust" claims at issue in this case relate to certain pre-bankruptcy "refund" obligations of the Debtor to its customers. Although pipeline customers pay for their purchases according to contract, the rates charged are generally subject to later review by the Federal Energy Regulatory Commission ("FERC") pursuant to the Natural Gas Act, 15 U.S.C. § 717 *et seq.* ("NGA"). If the FERC determines that the rates charged were too high, it may order refunds. See 15 U.S.C. § 717c(e).[3]

The specific funds that respondents contend the Debtor holds in "trust" are refunds that the Debtor received as a customer of its upstream pipeline suppliers. When the Debtor receives such refunds, it may, as here, owe refunds of like amounts to its own customers, because the service agreements between the Debtor and its customers generally tie the Debtor's rates to the *costs* it incurs in providing service, including charges from upstream pipelines.[4]

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[3] Specifically, FERC is empowered to ensure that rates charged by "natural gas companies," such as the Debtor, do not exceed "just and reasonable" levels. *See* 15 U.S.C. § 717c.

[4] Most of the refunds at issue here relate to upstream pipelines' costs associated with "take-or-pay" contract provisions that obli-

Importantly, no party disputes the Debtor's underlying contractual and legal refund *obligations* to its customers. On the contrary, under the NGA, those *obligations* must be respected, and under the Bankruptcy Code, the customers are afforded substantial rights to *payment* of their claims. Only trust property, however, is exempt from the Bankruptcy Code distribution scheme and its principle of equal distribution among creditors. Furthermore, as respondents concede, under traditional state law property and trust principles, the funds at issue here indisputably are property of the Debtor's bankruptcy estate.[5] Thus, the only

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gated them periodicially to pay for certain quantities of gas whether or not they actually took delivery of those quantities. In 1987, the FERC ruled that pipelines could bill their customers a portion of these costs of maintaining gas inventory on the basis of the customers' historical purchase decisions—*i.e.*, customers who had reduced their purchases, and who were therefore more responsible for take-or-pay costs, would be required to pay more of the take-or-pay bill. As a customer of upstream pipelines, the Debtor was charged such costs, and it subsequently billed its customers a like amount pursuant to its contracts with them. The FERC orders were vacated by the D.C. Circuit (*not* because the charges were deemed excessive or unreasonable, but because this after-the-fact allocation violated the technical prohibition against "retroactive ratemaking," *see Associated Gas Distribs.* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S. Ct. 277 (1990)). Under revised allocation methodologies approved by the FERC on remand, the Debtor's share of take-or-pay costs decreased significantly, and pursuant to its contracts with its customers and the FERC refund orders, the Debtor owes its customers refunds.

[5] Traditional state law trust principles focus on the intent of the parties as determined by objective indicia that signal the trust relationship to other parties. *See* Restatement (Second) of Trusts § 23 (1959) (a trust is created "only if the settlor properly manifests an intention to create a trust"). Accordingly, courts generally look to contractual expressions of intent, restrictions on the use of the funds, *id.* at § 12 comment g, segregation of the funds, *id.* at § 179 comment b, and the absence of any provision for the payment of interest, *id.* at § 12 comment g, in distinguishing a trust relationship from an ordinary debtor-creditor relationship. In this

issue is whether, as the court below held, some undefined federal policy "interest" unrelated to bankruptcy justifies preemption of otherwise applicable state law and entitles the customers to preferential payment ahead of the thousands of other creditors, including the United States, who have equally valid claims to the Debtor's property.

3. *The Proceedings Below.* On July 31, 1991, the Debtor filed with the United States Bankruptcy Court for the District of Delaware a petition for voluntary bankruptcy under Chapter 11 of the Bankruptcy Code. See 11 U.S.C. § 1101 *et seq.* Less than a month later, the Debtor sought authority preferentially to pay its customers' pre-bankruptcy refund claims totalling approximately $160 million. The bankruptcy court, creating and applying a new federal common law of "trusts," authorized the Debtor to disburse to its customers approximately $140 million as "trust" funds.[6] The bankruptcy court's decision to pre-empt established state law rested solely on the Debtor's character as a regulated entity, the existence of a regulatory statute and agency, and a perceived need for "uniformity."

The United States District Court for the District of Delaware reversed, rejecting respondents' claim of pre-emption. The district court reasoned that state law should apply where, as here

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case, it is undisputed that there were *no* contractual expressions of intent to create a fiduciary trust relationship; the Debtor was contractually and legally free to and did use the disputed funds *in any manner it saw fit*, including, *inter alia*, to service debt, to pay operating expenses, and to pay dividends; the Debtor made *no* attempt to segregate the disputed funds from its general accounts; and the Debtor is fully obligated to pay interest on its refund obligations. In sum, the respondents did *nothing* that could have alerted other creditors that the funds ostensibly in the Debtor's control were held in trust for its customers.

[6] Although the bankruptcy court held that *all* of the disputed funds were "trust" funds it found that approximately $20 million had been irretrievably disbursed prior to bankruptcy. App. 139a.

> we have two federal statutes, one of which (the NGA) is entirely silent on the issue of applicable law (trusts and bankruptcy), while the other (the Bankruptcy Code) directs review according to traditional state law principles. With regard to each statute, Congress obviously has the power of clarification; we read the silence of Congress in the NGA as supporting the application of state law principles. Furthermore, where there is a conflict between the Bankruptcy Code and a competing statute, the Code, generally, takes precedence. *NLRB* v. *Bildisco and Bildisco*, 465 U.S. 513, 532 (1984). . . .

App. 100a-101a. Turning to applicable state law, the court found *no* evidence of a trust between the Debtor and its customers, *id.* at 103a, a finding which respondents did not challenge on appeal.

A divided panel of the Third Circuit reversed the district court and again authorized the Debtor to distribute the disputed funds as "trust" funds. *Id.* at 38a. The court of appeals held that, because the Bankruptcy Code defines "property" of the estate, trust determinations in bankruptcy *necessarily* are governed by federal law. *Id.* at 47a. The only real issue, according to the court, was whether it should "fashion a uniform federal common law rule or adopt state law as the federal rule of decision." *Id.* Reasoning that the application of "state law to determine [the Debtor's] property rights in the refunds would frustrate the Natural Gas Act's central purpose," *id.* at 49a, the court of appeals adopted a result-oriented federal common law "rule" completely unmoored from any traditional trust principles. *See id.* at 71a ("nothing indicates one way or the other whether the parties intended to create a trust" and "[n]one of the traditional indicia of a trust relationship . . . [was] present") (Nygaard, J., dissenting).[7]

[7] On August 6, 1993, the Third Circuit, with two judges dissenting, denied the Creditors Committee's request for rehearing and suggestion for rehearing *en banc*.

REASONS FOR GRANTING THE PETITION

The decision below has greatly exacerbated the existing conflict among the circuits with regard to the circumstances, if any, under which Congress has authorized federal courts to preempt the established state property and trust law called for by the Bankruptcy Code in favor of newly-created federal common law designed to further policy interests unrelated to bankruptcy. This Court has long recognized that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." See *Butner* v. *United States*, 440 U.S. 48, 54 (1979).[8] *Butner* left open the possibility, however, that federal law might apply where an "identifiable" federal interest *"requires* a different result." *Id.* at 55 (emphasis added).

In the wake of this Court's decision to leave open the possibility of preemption, the courts of appeals have taken widely diverging approaches to the appropriate scope of federal common law preemption. The Seventh Circuit has narrowly construed the *Butner* dicta consistent with this Court's federal common law jurisprudence—*i.e.*, preemption may occur only upon demonstration of a "substantial conflict" between state law and a "concrete federal interest" that is "*clearly* important." See *In re Iowa R.R.*, 840 F.2d 535, 540-42 (7th Cir.) (emphasis in original), *cert. denied*, 488 U.S. 899 (1988). In the Sixth Circuit, by contrast, an *ad hoc* judicial finding that a particular substantive result furthers a federal "interest" as nebulous as fostering "a unified national rail system" justifies abandoning state law in favor of federal common law expressly designed to achieve that result. See *In re Ann Arbor R.R.*, 623 F.2d 480 (6th Cir. 1980). And in the Third Circuit, the federal common law exception has now completely swal-

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[8] *Butner* rejected the Third Circuit's federal common law approach to analyzing whether a security interest in a bankrupt's property extends to rents and profits derived from the property.

lowed the state law rule—the decision below holds that federal law governs *all* trust determinations under § 541 (d) of the Bankruptcy Code. Indeed, all that remains of the choice of law issue in the Third Circuit is whether, in a particular case, the *federal* rule of decision should be informed by state law principles. See App. 47a. Thus, it is beyond dispute that the well-reasoned decision of the Seventh Circuit in *"Iowa R.R.* is a complete rejection of" the Third Circuit's expansive and unprecedented federal common law approach, *Missouri Pac. R.R. Co.* v. *Escanaba & Lake Superior R.R.*, 897 F.2d 210 (6th Cir. 1990), and this case presents a proper vehicle for resolving that circuit split.

The decision below also is flatly inconsistent with numerous decisions of this Court recognizing that widespread federal common law preemption threatens core principles of federalism and raises serious democratic process concerns. In contrast to the decision below, this Court has carefully limited the scope and content of federal common law. See, *e.g., United States v. Texas,* 113 S.Ct. 1631 (1993). Specifically, the decision below is inconsistent with prior decisions of this Court (a) narrowly confining the scope of federal common law, see, *e.g., Texas Indus., Inc. v. Radcliff Materials, Inc.,* 451 U.S. 630, 641 (1981), (b) cautioning that even in those rare instances in which federal common law is appropriate, federal courts generally should incorporate state law as the federal rule of decision, see, *e.g., United States* v. *Kimbell Foods, Inc.,* 440 U.S. 715, 728 (1979); *Kamen* v. *Kemper Fin. Servs., Inc.,* 111 S. Ct. 1711, 1717 (1991), and (c) refusing to find preemption in fields, such as property and trust law, that traditionally have been regulated by the states "unless that was the clear and manifest purpose of Congress," *Hillsborough County* v. *Automated Medical Labs., Inc.,* 471 U.S. 707, 715 (1985) (internal quotations omitted).

Because numerous industries now are subject to federal regulation, resolving the issue of what law governs rights

in the property of federally-regulated bankrupts is of tremendous practical importance. The divergence between the decision below, which sanctions the creation of federal common law property rights on an essentially *ad hoc* basis, and the prior decisions of the Sixth and Seventh Circuits, has left the nation's creditors generally helpless to anticipate the extent of a federally regulated debtor's assets. See *In re Iowa R.R.*, 840 F.2d at 544. Moreover, the court of appeals' approach, under which an ordinary creditor is transformed into a "trust" beneficiary whenever some federal policy interest unrelated to bankruptcy might be advanced, invites wholesale departure from Congress' policy of equal distribution and the exhaustive payment priority scheme established in the Bankruptcy Code in favor of *ad hoc* judicial priority determinations. Indeed, the decision below renders meaningless Congress' careful decisions in numerous other settings expressly granting certain entities priority claims to the assets of regulated debtors.[9]

Finally, the approach of the court of appeals prejudices, among others, the United States, which asserts a $600 million priority claim against the Debtor. Indeed, the broad holding of the court below threatens the United States' statutory priority in countless future bankruptcies. Accordingly, it is reasonable to expect that the United States would urge the Court to decide this issue—and thereby determine whether judicial policy determinations may overrule the express statutory priorities that the United States enjoys with respect to certain claims, see 11 U.S.C. § 507(a)(7) & (8)—if its views were solicited.[10]

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[9] *See, e.g.*, 7 U.S.C. § 499e(c)(2) ("[p]erishable agricultural commodities received by [a regulated broker] shall be held by such [broker] in trust for the benefit of all unpaid suppliers"); 26 U.S.C. § 7501 (federal taxes withheld by employers are "held to be a special fund in trust for the United States").

[10] Department of Justice officials responsible for Internal Revenue Service litigation authorized petitioner to note the United States'

1. The Third Circuit first addressed the issue of the appropriate body of law to apply in assessing trust claims against a federally-regulated bankrupt in *In re Penn Cent. Transp. Co.*, 486 F.2d 519 (3d Cir. 1973) (en banc), *cert. denied*, 415 U.S. 990 (1974). In that case, "interline" railroads sought trust status for claims to a portion of a bankrupt railroad's collections for long-haul shipments that had used the facilities of both the bankrupt and the interlines. Without explanation, the court analyzed the issue under federal law. This new federal common law of trusts, however, departed only slightly from traditional state law principles. Thus, the federal analysis focused on contractual expressions of intent to create a trust, the lack of any provision for the payment of interest, and the interline railroads' ability to restrict the debtor's use of the disputed funds. See *Penn Central*, 486 F.2d at 524-27. Indeed, the court noted the presence of all but one of the traditional state law indicia of trust. *Id.* at 527 ("[w]e perceive no need to announce an entirely new and necessarily result-oriented rule of law," because "recognized trust and pragmatic considerations . . . are appropriate to any industry").

Eight years later in another interline railroad case, the Third Circuit belatedly provided the rationale for the approach adopted in *Penn Central*. See *In re Lehigh & New England Ry.*, 657 F.2d 570 (3d Cir. 1981). Citing this Court's decision in *Clearfield Trust Co.* v. *United States*, 318 U.S. 363 (1943), the court of appeals listed

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support of petitioner's position in briefs before the District Court. And the United States recently filed an objection to a subsequent request by the Debtor preferentially to pay additional customer refunds (App. 183a-186a). Moreover, at the request of the Debtor's customers, the Federal Energy Regulatory Commission filed an *amicus* brief with the court of appeals supporting respondents' position. Accordingly, in light of the clear importance of the issues raised in this case to various departments and agencies of the United States, it seems likely that the United States would urge this Court's review of the decision below.

four factors to justify federal common law preemption: (1) "the funds in question arose out of railroad operations in interstate commerce, the regulation of which is under the exclusive control of Congress," (2) "Congressional concern with the establishment and maintenance of a viable national rail system has been expressed in . . . the Interstate Commerce Act," (3) "by establishing the Interstate Commerce Commission, Congress sought to regulate interstate commerce by rail," and (4) "it is manifest that uniformity is required." *Lehigh,* 657 F.2d at 575. Of course, in every case in which an activity or industry is subject to federal regulation, there exists a federal regulatory statute and a federal regulatory agency, and by definition one reason for national regulation is always uniformity.[11] Thus, in the Third Circuit the mere existence of federal regulation suffices to preempt state trust and property law. Notwithstanding this extremely broad role the *Lehigh* court scripted for federal common law in making property rights determinations in bankruptcy, however, that court again turned to traditional state-law principles to give content to the federal rule of decision. *Id.* at 578.[12]

In 1988, the Seventh Circuit expressly rejected *Penn Central* and its federal common-law progeny and held that *state* law should govern claims against a federally-regulated bankrupt railroad. *In re Iowa R.R.*, 840 F.2d 535. Citing this court's decision in *Miree* v. *DeKalb County,* 433 U.S. 25 (1977), Judge Easterbrook, writing for the Seventh Circuit, reasoned that the mere fact that "the dispute involves the interstate transportation network is not enough" to justify preempting state law. *In re Iowa R.R.* at 540. "[O]nly a demonstration of a *substantial* conflict

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[11] Ironically, the Third Circuit has since recognized that *state* trust law *is,* for all practical purposes, a nationally uniform body of law. *See, e.g., Smith v. Williams,* 698 F.2d 611, 614 (3d Cir. 1983).

[12] The Sixth Circuit adopted a similar approach in *In re Ann Arbor R.R.*, 623 F.2d 480 (6th Cir. 1980).

between state law and the achievement of an objective defined by federal law would support a conclusion that federal law controls." *Id.* (emphasis added). Furthermore, [e]xtensive regulation is no substitute for a conflict." *Id.* (citing *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355 (1986)). Judge Easterbrook concluded that favoring certain creditors of a brankrupt in the hopes of furthering generalized federal policy interests unrelated to bankruptcy, such as "the preservation of a national transportation system," is "not so *clearly* important that a federal court may create federal common law to trump the state law that governs competing claims to a debtor's funds." *Id.* at 542 (emphasis in original).

"Iowa R.R. is a complete rejection of *Penn Central . . . ." Missouri Pac. R.R.*, 897 F.2d at 213. That this Court chose *not* to review the issue at the time, however, is not surprising. First, the Third Circuit's federal common law approach had not been widely adopted nor extended beyond the interline railroad context. Second, in light of the powerful reasoning of the Seventh Circuit and the corresponding lack of analysis in the prior Third Circuit opinions, it was reasonable to expect that the Seventh Circuit approach might ultimately prevail. Finally, and most importantly, while the circuits were clearly split on the choice of law question, the Third and Sixth Circuits' consistent adoption of traditional state law trust principles as the federal rules of decision minimized the potential harm arising out of the decisional conflict.

These reasons for delaying review of this important issue and resolving the circuit split have disappeared with the decision of the court of appeals here. First, the court of appeals extended the application of federal trust law well beyond the narrow interline trust context. It is now available in all bankruptcies of federally regulated entities. Second, the court greatly expanded the role of federal common law to *all* trust determinations pursuant to § 541(d). In the Third Circuit, the existence and na-

ture of regulation now determines only whether federal common law will be informed by state law principles. And finding such regulation here, the court of appeals completely disregarded traditional state law trust principles and created result-oriented federal common law principles out of whole cloth.[13] Compare *Columbia Gas Transmission Corp.* v. *Exclusive Natural Gas Storage Easement*, 962 F.2d 1192 (6th Cir.), *cert. denied*, 113 S. Ct. 659 (1992). Thus, in the Seventh Circuit, federal law will rarely, if ever, preempt state trust law with respect to claims against a federally-regulated bankrupt, while in the Third Circuit federal law now will *always* preempt state law—and generally change the outcome—in those circumstances.

2. Moreover, the decision of the Third Circuit goes well beyond the narrow grounds under which this Court previously has permitted the creation of federal common law, especially where, as here, "*private parties* have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards." *Kamen* v. *Kemper Fin. Servs., Inc.*, 111 S. Ct. 1711, 1717 (1991) (emphasis added). The extremely limited role for federal common law embodied in this Court's landmark decision of *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), rests on deeply rooted notions of democratic process and federalism.[14] In order to maintain this

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[13] As the dissent below recognized, *none* of the traditional indicia of a trust relationship—which focus on the parties' expression of intent to create a legal trust relationship—is present here. App. 70a (Nygaard, J., dissenting).

[14] *See, e.g., Milwaukee* v. *Illinois*, 451 U.S. 304, 312-13 (1981) ("[t]he enactment of a federal rule in an area of national concern, and the decision whether to displace state law in doing so, is generally made not by the federal judiciary, purposefully insulated from democratic pressures, but by the people through their elected representatives in Congress"); *Boyle* v. *United Technologies Corp.*, 487 U.S. 500 (1988) (Brennan, J., dissenting). *See also* Martha A. Field, *Sources of Law: The Scope of Federal Common Law*,

proper structural balance, courts must "start with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the *clear and manifest purpose of Congress.*" *Puerto Rico Dep't of Consumer Affairs* v. *Isla Petroleum Corp.*, 485 U.S. 495, 500 (1988) (emphasis added) (citations omitted).

Accordingly, even in those rare instances in which a uniform federal rule is warranted, this Court has repeatedly cautioned that the federal rule generally should be fashioned from traditional common law principles rather than created from whole cloth. See, *e.g.*, *Kimbell Foods*, 440 U.S. at 728; *Kamen*, 111 S.Ct. at 1717. As this Court declared only last Term, "[s]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident." *United States* v. *Texas*, 113 S. Ct. 1631, 1634 (1993) (quoting *Isbrandtsen Co.* v. *Johnson*, 343 U.S. 779, 783 (1952)). "In order to abrogate a common law principle, the statute must '*speak directly*' to the question addressed by the common law." *Id.* (quoting *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618, 625 (1978)).

The decision below, by contrast, sanctions federal common law preemption on nothing more than an unsupported inference that Congress (and the FERC), *had they considered the issue*, would have excused state-regulated gas distribution companies from the traditional principles of property and trust law that govern all other creditors' relationships with bankrupt gas pipelines. The simple fact is that neither Congress nor the FERC has done so,[15] however, and federal courts have no authority

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99 Harv. L. Rev. 883, 931-35 (1986) (discussing implications of federal common law on federalism).

[15] Indeed, until its brief to the Third Circuit, the FERC's expressed policy had always been that FERC-ordered refund obligations yield ordinary unsecured claims in bankruptcy. In *Transamerican Natural Gas Corp.*, 41 FERC ¶ 62,206, at p. 63,454 (1987),

to make such policy determinations. In any event, it is well established that Congress' purpose in enacting the NGA was limited to protecting gas consumers from *monopoly power*,[16] not protecting gas distribution companies from the ordinary risks of bankruptcy (or of fraud, economic downturns, natural disasters, etc.) faced by all commercial entities. Indeed, neither the language nor the legislative history of the NGA makes *any* reference whatsoever to bankruptcy. That statutory silence is telling because Congress clearly knew how to preempt state law to protect particular interest groups from the risks of bankruptcies by their trading partners. See *supra* note 9. The decision below is an unprecedented and dangerous expansion of the previously narrow scope of federal common law preemption.[17]

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for example, a bankrupt's request to the FERC for postponement of its refund obligations was denied because: "refusal to grant postponement . . . merely leaves the persons owed . . . refunds in the same position as [the debtor's] other creditors. Disposition of [the debtor's] assets in order to discharge its debts, including . . . refunds, is a matter for the court handling [the debtor's] bankruptcy proceeding."

[16] *See, e.g., Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 143 (1960); FERC Order No. 636-A, 57 Fed. Reg. 36,128, 36,136 (1992).

[17] Respondents attempt to obscure the broad implications of the standardless federal common law approach adopted below with a "public interest" smokescreen. Immediate payment of these customers' refund claims is necessary, they say, to insure that the customers' customers, residential gas consumers, have access to cheap gas to heat their homes and cook their food. However, it is gas distribution *corporations*, and *not* the gas-consuming public, that seek the disputed funds. And although receipt of refunds from the Debtor may well trigger refund obligations on the part of those distribution corporations to gas consumers, *nothing* prevents the respondent state public utility commissions from ordering those large corporations to accept the consequences of their decisions to do business with the Debtor and immediately refund to the gas-consuming public any amounts that those consumers were overcharged.

3. Because so many industries are now subject to some federal regulation, resolving the issue of what law governs rights in the property of federally-regulated bankrupts is of tremendous practical importance. First, by departing from established common-law trust principles in reliance upon which existing debtor-creditor relationships were premised, the Third Circuit has greatly upset established government and commercial expectations of pipeline creditors [18] and others.[19]

Second, the adverse impact of the decision below on the orderly bankruptcy system will be dramatic. The purpose of the statutory bankruptcy priority and distribution scheme was to replace costly and disruptive creditors' races to courthouses with an orderly process for the fair distribution of the bankrupt's assets. See *Begier* v. *IRS*, 496 U.S. 53, 58 (1990). By abandoning strict state law trust principles in favor of a result-driven policy approach to "trust" claims, the Third Circuit has invited exactly the type of standardless *ad hoc* adjudica-

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[18] All prior decisions by the FERC and the Third Circuit, including *Penn Central*, indicated that a pipeline's refund obligations could only be classified as unsecured debt. *See, e.g., supra* note 15; *In re Lehigh & New England Ry.*, 657 F.2d 570 (3d Cir. 1981). And, as the Sixth Circuit noted in *In re Ann Arbor R.R.*, 623 F.2d 480, 481 (6th Cir. 1980), *Penn Central* is a "landmark decision" that has been relied upon both by courts and by industry. Thus, a vast number of creditors, including the United States, will now find themselves collecting much less on their debts than anticipated because of the new preferred regulatory trust status created by the Third Circuit.

[19] Moreover, the Third Circuit's result-driven approach to federal common law preemption has inadvertently created the potential for an enormous volume of federal court litigation over the handling of refunds by pipelines. With the creation of a "trust" comes fiduciary obligations that are completely foreign to pipelines' handling of refunds. But now, every downstream consumer apparently has a "federal common law right"—enforceable in federal court—to challenge how upstream and downstream pipelines handle these monies.

tions that the statutory bankruptcy scheme was designed to avoid. Virtually any creditor of a federally-regulated bankrupt can make a credible argument that *some* generalized federal policy would be furthered by ensuring that it is paid in full, and there can be no doubt that all such creditors will press such "trust" claims in the future. *Cf. Elliott* v. *Bumb*, 356 F.2d 749, 755 (9th Cir.) (allowing state to avoid common law trust requirements "would open the door to state creation of priorities in favor of various classes of creditors by labeling such priorities as 'trusts.' This would tend to thwart or obstruct the scheme of federal bankruptcy"), *cert. denied*, 385 U.S. 829 (1966).

Third, and perhaps most important, the decision below leaves *all* creditors of federally-regulated entities helpless to anticipate the extent of the assets that will be available in the event of bankruptcy. An orderly bankruptcy process is important not only to creditors of insolvent entities, but also to the creditors of solvent entities *ex ante*, because terms of credit necessarily depend upon creditors' estimates of the risk of bankruptcy and their priority to assets ostensibly held by their debtors. And common law trust requirements provide the type of predictable legal framework necessary for vital credit markets. Under common law, a creditor could readily ascertain which assets held by the debtor were trust funds merely by observing, for example, whether any contractual relations exist which indicate a trust, whether the debtor paid interest, commingled the funds, or was restricted in any way from using the funds for its own purposes prior to distribution. See *supra* note 5. However, under the standardless "rule" announced by the Third Circuit, a creditor is placed in the impossible position of guessing how federal judges will evaluate numerous generalized federal policy interests unrelated to bankruptcy. This will have a drastic and negative effect on the credit market for interstate pipelines and other federally regulated entities.

Ironically, the decision below ultimately will hurt the very consumer interests it purports to advance. If pipelines are able to insulate certain creditors from risk, here their customers—many of whom are affiliates—they necessarily expose other creditors to more risk. These creditors, in turn, must in the future charge a higher interest rate to compensate themselves for the greater risk they bear due to the standardless loosening of the Bankruptcy Code's strict priority system. And the rates of many federally regulated entities, including those of the Debtor, are cost-based. Thus, these extra financing costs will be incorporated into the pipeline's rates and passed on to its customers (and eventually to ultimate consumers). "There is no panacea" in making a pipeline's customers better off by giving them preferred status to other creditors. *In re Iowa R.R.*, 840 F.2d at 542.[20]

At bottom, *no* substantial federal interest is furthered by abandoning established state law trust principles here. But there is much to fear from the Third Circuit's unprecedented and unwarranted expansion of federal common law preemption principles. Only review by this Court of the decision below can allay those legitimate fears.

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[20] Importantly, holding state-regulated gas distribution companies to the same state common-law rules as other commercial entities does *not* prevent them from reducing the risk of bankruptcy by establishing trust relationships. On the contrary, it merely requires them to establish those relationships—and thereby give notice to other creditors—*before* the pipeline bankruptcy (by, for example, merely expressing in their contracts with pipelines their intent to create trusts).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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November 3, 1993

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